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L. Randall Wray

The Jerome Levy Economics Institute of Bard College

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If you were to write yourself IOUs to provide for your retirement and put them in a safety deposit box, would you rest comfortably, assured that you would be able to purchase all the necessities of life in 2020? Well, President Clinton's plan is even worse.

In his State of the Union Address, President Clinton offered his proposal for "saving" Social Security by "committing" 60 percent of projected government budget surpluses for the next 15 years to that purpose. This was widely, and wildly, hailed as the right thing to do. But does it make any sense?

The president's plan relies critically on several unexamined assumptions. Most obviously, it relies on budget surpluses far into the future. The plan would "transfer" more than $2.7 trillion from projected general budget surpluses to the Social Security Trust Fund over the next 15 years. The president's unbounded optimism allowed him to claim, "We are on a course for budget surpluses for the next 25 years," but our nation has never—let me repeat, *never*—run budget surpluses for such a period. Indeed, every time we had significant surpluses, the economy quickly collapsed into a depression that created budget deficits. Our federal government *will not* run surpluses for the next 25 years or the next 15 years. But if simply wishing for something can make it so, why not project surpluses for the next 1,000 years that would total billions of quadrillions and use a measly 5 percent of that to solve the Social Security problem?

L. Randall Wray is a senior scholar at The Jerome Levy Economics Institute.

Close examination of the president's projections (as presented by the Office of Management and Budget) reveals that the federal government will continue to run a significant "on-budget" deficit through 2003, with "off-budget" revenues accounting for all the projected surpluses. These off-budget revenues come entirely from Social Security taxes. According to projections of the Social Security Trustees, payroll tax revenues will exceed Old-Age and Survivors Insurance and Disability Insurance (OASDI) expenditures by $119 billion in 2003, with the surplus rising to $159 billion in 2008. Looking at the two projections together shows that the president's projected surplus of $150 billion in 2003 will be achieved mainly thanks to the $119 billion surplus run by Social Security. In other words, 60 percent of federal budget surpluses—created for the most part by Social Security—is being counted toward saving Social Security!

However, the real question remains: Will setting aside any surpluses realized during the next several years really help ease the budgetary burden of the baby boomers' retirement? To answer this question, one must understand that when OASDI runs a surplus, the Treasury creates an interest-earning IOU, a nontradable bond, that is held by the Social Security Trust Fund. This IOU is essentially a debt the government owes itself. Because the overall federal budget (including off-budget revenues) is projected to run surpluses in the coming years, the Treasury will actually retire some outstanding bonds held by the public each year, with the amount retired being somewhat less than the projected surpluses (hence President Clinton's claim that the outstanding *publicly held* stock of government debt will fall). Curiously, the gross federal debt will actually rise by nearly $600 billion by 2003 *in spite of projected surpluses* because the Treasury will have to create debt to be held by OASDI. Thus, while it is true that the public will hold fewer bonds, the government will become increasingly indebted—*to itself.*

Even if the federal government could maintain a balanced budget forever, the Treasury would have to go into debt by another $2.3 trillion by 2020 as it issues bonds to be held by the Trust Fund; according to the Social Security Trustees' more optimistic assumptions, the Treasury would have to create $51 trillion in new bonds to be held by OASDI between today and 2075. Remember, this is debt that will be created so that the government can owe itself. President Clinton's plan would increase the government's indebtedness (to itself) by another $2.7 trillion because the Treasury would issue debt equal to 60 percent of the government's surpluses to be added to the Trust Fund's accumulation of bonds. The greater the surpluses, the more indebted the Treasury becomes! To complicate the already Byzantine nature of these finances, the Treasury pays compound interest on all this debt by issuing more IOUs to the Trust Fund—the higher the interest rate, the more the government owes itself and, hence, the sounder Social Security becomes. If you can follow the accounting logic of all this, the Clinton administration may have a position for you.

Will this debt—whether it is "set aside" or not—help to provide for retiring baby boomers? If you were to write yourself IOUs to provide for your retirement and put them in a safety deposit box, would you rest comfortably, assured that you would be able to purchase all the necessities of life in 2020? Of course not. But isn't that what President Clinton's plan amounts to? No—actually his plan is even worse.

What if a pension fund approached you with a retirement plan according to which you were to pay a safety deposit box fee equal to 2 percent of your annual income so that you could safeguard your own IOUs to be taken out of the box in 2020 and sold in order to raise the cash required to support you in your old age? You would rightly argue that if sales of your own IOUs can really support you in your old age, you would prefer to write them in 2020 rather than paying the 2 percent annual fee; that would at least allow you to consume, or to save, the 2 percent in the meantime.

President Clinton's plan consists of taxing current workers about 2 percent more than is needed to cover all OASDI expenditures, writing IOUs that are stored at the Treasury, and then taking out the IOUs in 2020 and turning them back over to the Treasury, which will then have to raise cash by issuing bonds or increasing taxes—exactly what would have to be done regardless of the existence of the Trust Fund. Unless retirees can eat Treasury bonds, the president's plan will have done nothing to provide for them.

Milton Friedman recently made a similar argument. He pointed out that paying taxes today to build up a trust fund cannot help provide for future retirees. Indeed, a trust fund is little more than an accounting gimmick.

> Taxes paid by today's workers are used to pay today's retirees. If money is left over, it finances other Government spending—though, to maintain the insurance fiction, paper entries are created in a "trust fund" that is simultaneously an asset and a liability of the Government. When the benefits that are due exceed the proceeds from payroll taxes, as they will in the not very distant future, the difference will have to be financed by raising taxes, borrowing, creating money or reducing other Government spending. And that is true no matter how large the "trust fund." (Milton Friedman, "Social Security Chimeras," *New York Times,* January 11, 1999, A17)

To be fair, there is nothing necessarily wrong with planning to use borrowing or additional taxes in 2020 to care for retiring baby boomers. Indeed, there is no alternative. But why doesn't the president simply state that that is his plan? It makes no sense to tax current workers more than is needed to cover current expenditures simply to allow the government to increase its debt to itself to maintain the subterfuge that this somehow will allow it to avoid doing what it must do in 2020. Current workers could enjoy a tax cut now, and this would have no impact whatsoever on what must be done in 2020 to provide for retirees.

The current notion behind the operation of OASDI is to accumulate financial assets now, in the belief that these can be depleted in later years when Social Security program expenditures exceed the revenues that will be generated from a shrinking taxable base. In other words, the "saving" represented by the annual surpluses will be accumulated over the next 20 years in order to provide for future "consumption" by retiring baby boomers. Clearly, the retirees will not be able to "consume" the Trust Fund (which will consist solely of bonds backed by the full faith and credit of the U.S. government). They will need a "real" basket of consumer goods when they retire. The question is this: Can the current generation, as a whole, save in real terms for its future retirement?

If the current generation were to abstain from consumption, dig holes, and bury goods and services to be excavated and consumed 20 years hence, we could clearly provide for future consumption by saving (in real terms) today. Presumably, the pharaohs had something like this in mind when they buried goods, as well as those who would provide services, with them in the pyramids. However, today, outside of the stockpiles of a handful of "survivalists," this sort of real saving is not significant. That is, most of the consumption that occurs in, say, 2020 will have to be provided for by production in that year, with the notable exception of owner-occupied housing. In other words, the Social Security Trust Fund (and all other public and private pension funds) are "saving" only in financial terms, in the hope that retirees will be able to purchase real goods and services at the time they retire for consumption at that date.

It makes no sense to tax current workers more than is needed to cover current expenditures simply to allow the government to increase its debt to itself to maintain the subterfuge that this somehow will allow it to avoid doing what it must do in 2020. Current workers could enjoy a tax cut now, and this would have no impact whatsoever on what must be done in 2020 to provide for retirees.

Is it possible for society to do anything today to increase the quantity of goods and services that can and will be produced in 2020 for consumption not only by retirees but also by all nonretirees (working or not working)? If not, the financial savings represented by the Social Security Trust Fund (and all the other public and private pension savings) can affect only the *distribution* of goods and services produced in 2020. The current debate, then, seems to center around a fear that if we do not "reform" Social Security, the retiring baby boomers will not get a sufficient share of society's output in 2020 or some later year.

If this is really what the debate is all about, the president's proposal does no good. His reform aims to increase the size of the Trust Fund and its rate of growth over the future (by "investing" a portion of it in the stock market to obtain higher returns than those expected from its government bonds), thereby postponing the "day of reckoning" by 55 years, according to his calculations. However, unless accumulation of the Trust Fund actually enhances society's ability to produce goods and services in the year 2020, the amount to be distributed will be exactly the same whether the Trust Fund is larger or smaller. The only economic justification for an accumulation of assets is the belief that it will increase the distribution going to retirees. However, there is no way to guarantee that the accumulation of assets in the Trust Fund will actually bring about this result, and it is not clear that a larger fund will result in a more desirable distribution.

Is there a better and more direct way to ensure that the distribution will be shifted toward retiring baby boomers? Yes—through the tax system. In the year 2020, if it is decided that the elderly should get a larger share of the distribution, then payroll taxes would be increased (reducing disposable income of workers and thus their consumption), allowing benefit payments to the elderly to rise. (According to the Social Security Trustees' current intermediate projections, the payroll tax rate will have to be increased by 2.26 percent—1.13 percent each on employers and employees—in 2020 to generate enough revenue to cover OASDI expenditures.)

In conclusion, it would be far more straightforward simply to increase the tax on workers in the year 2020 and increase the benefits paid to retirees at that time than to try to accumulate financial reserves over the next 21 years in the hope that the OASDI Trustees could affect distribution by turning bonds back to the Treasury, which would then sell bonds in the year 2020 to raise the cash it would turn over to OASDI. This could work smoothly only if those who obtained income from working in the year 2020 decided to reduce consumption in the year 2020 in order to buy bonds. It is possible, perhaps likely, that the asset sales would merely depress asset prices and that the competition for consumption by workers and retirees would drive up prices of goods and services. While it is conceivable that the net result would be a greater distribution going to the elderly, that is not a foregone conclusion. Why not simply use the tax system in the year 2020 or 2030 or 2075 to guarantee the desired result?

The burden of providing real goods and services to retirees in 2020, 2030, or 2075 will be borne by workers in those years regardless of the tax imposed today. And if the amount to be produced cannot be increased by actions taken today, then the burden that will be borne cannot be reduced by anything we do today. Nothing the president has proposed will reduce the burden placed on workers in the year 2020. The president has merely asked workers today to make a sacrifice by paying unnecessarily high taxes without in any way shifting the burden from future workers. This is pain without gain and is bad public policy.

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The Jerome Levy Economics Institute of Bard College
Blithewood
Annandale-on-Hudson, New York 12504-5000
Phone: 914-758-7700, 202-887-8464 (in Washington, D.C.) *Fax:* 914-758-1149
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